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FEDERAL COMMUNICATIONS COMMISSION
OFFICE OF THE SECRETARY

BEFORE THE
FEDERAL COMMUNICATIONS COMMISSION
Washington, DC 20554

In the Matter of	)	
	)	
Implementation of Sections of the Cable Television Consumer Protection and Competition Act of 1992	))))	MM Docket No. 93-215
	)	
Rate Regulation	)	

COMMENTS OF MEDIA GENERAL CABLE
<u>OF FAIRFAX COUNTY, INC.</u>

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August 25, 1993

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SUMMARY OF PLEADING

Media General Cable of Fairfax County, Inc. ("Media General") submits its comments for consideration by the Commission in the agency's cable cost-of-service rulemaking.

There is one fundamental conclusion important to many aspects of matters as to which the Commission has requested comment. Some cable systems, including Media General, are quite different from the "average" cable system -- in terms of cost -- for which the Commission can adequately set rates by benchmark/adjusted historic measures with price cap carry forwards. Those differences must be respected by the Commission, in terms of the way in which it regulates rates, if the Commission is to avoid confiscatory regulation. The cost-of-service procedure provides the constitutional safety valve for what would, without that release, raise grave constitutional issues. Thus, the Commission should structure a cost-of-service process that permits cable systems broad latitude in establishing what their actual and reasonable costs of service are.

For a company in Media General's position -- that is, a company that obtained a franchise, built and has continuously operated a cable system -- one important element of necessary cost recovery is historic operating losses. Media General has generated rather substantial accumulated operating losses and must be given the opportunity, over a reasonable period of

amortization, to recover those accumulated losses through future rates.

An obviously important element in rate regulation is the determination of the useful life of system assets for purposes of establishing the appropriate annual depreciation expense associated with those assets. For cable systems, like Media General, that have audited financial statements, auditors are bound by GAAP, and the associated oversight of the Financial Accounting Standards Board, to use appropriate depreciation lives. Because the appropriate life may differ from system-to-system, the wise regulatory approach is to rely on the integrity of auditors to establish depreciation lives rather than to prescribe a single, and at least occasionally inappropriate, depreciation life for all cable system assets.

Cost-of-service based rates should be rolled forward under an appropriate price cap mechanism from year-to-year until such time as a cable system desires again to litigate cost of service. Media General suggests that a metropolitan area-specific inflater should be employed where a system can, in the course of its cost-of-service adjudication, establish that inflation in the area of its cable system is considerably greater than the national average.

The public interest will be best served by permitting cable operators to mark-up, by a reasonable margin, their cost of providing programming. This course will conduce the best array of video services for cable subscribers and will not necessarily lead to higher rates.

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**COMMENTS OF MEDIA GENERAL CABLE
OF FAIRFAX COUNTY, INC.**

Media General Cable of Fairfax County, Inc. ("Media General") provides these comments in response to the Notice of Proposed Rulemaking in the above-captioned proceeding released July 16, 1993, concerning cost-of-service proceedings (the "Notice").

I. The Need to Preserve the Opportunity for Cost-of-Service Showings

Portions of the Notice reflect a role for cost-of-service showings that is precisely congruent with what Media General believes is appropriate. The following extract from paragraph 10 of the Notice is a good example of this:

> We solicit comment on whether our regulatory framework for cost-based rates should also be guided by the goal of producing rates that approximate competitive rate levels, i.e., rates that approach the operators' costs. The key distinction between the benchmark/price cap approach and the cost-based approach, however, is that operators making a cost-of-service showing are seeking to justify rates that exceed the benchmarks but that nevertheless are reasonable because they are based on costs, as determined under our requirements.

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Media General submits that the Commission has it exactly right in its twinned formulation of the function of cost-of-service showings.

Other queries in the Notice are sufficiently adrift from this apparently solid understanding to raise serious questions. The Notice asks the following question, for example:

> In particular, we request comment on what rate levels our cost-based requirements should produce in relation to benchmark rates.

Notice, ¶ 7. There plainly is no necessary relationship between rates based on a proper cost-of-service procedure and those established by the averaging process that led to the benchmark rates. Conceivably, there may emerge out of some number of adjudications of cost-of-service showings some linkage between what systems are able to establish as their reasonable cost of providing service and the benchmark rates, but there is certainly no way to know in advance of such adjudications what those relationships might be or even whether there will be any such relationships.

It is a mistake, moreover, to propose eligibility hurdles for those wishing to take advantage of the cost-of-service alternative to benchmark/adjusted historical rate pricing as the following passage suggests that the Commission might:

> We also solicit comment on whether we should establish procedural limits or bars on cost-of-service showing seeking to justify rates higher than existing rates absent a demonstration of special circumstances or extraordinary costs. Under this approach, absent a special showing, we would not entertain cost-of-service applications to justify initial regulated rates higher than the systems' existing rates.

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Notice, ¶ 18. Encumbering the cost-of-service showing process with entry barriers might not be a bad idea if the Commission were in possession of knowledge sufficient to structure those barriers in a way that would exclude only those with no prospect for prevailing in the full cost-of-service proceeding. We submit, however, that the Commission does not, at least yet, have such information and is much better advised in trusting the internal cost knowledge of system operators and their balance of the cost of prosecuting a cost-of-service proceeding against their assessment of the prospects of success to curb improvident cost-of-service litigation. To do anything else is to run the risk that systems genuinely unable to cover their costs, including a reasonable return on investment, under the benchmark/adjusted historical rate system will be forced to operate at a loss, an outcome that is almost certainly unconstitutional[1/] or to debase the quality of services that they provide, which Media General does not believe to have been the Congress' ambition.

A similar infirmity attaches to the analysis of "Streamlining Alternatives" at ¶¶ 73-75 of the Notice. So long as none of these alternatives is imposed as a substitute for the availability of full cost-of-service showings, Media General obviously has no objection to the quest for

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1/ See, e.g., In re Permian Basin Area Rate Cases, 390 U.S. 747, 768-71 (1968).

administrative efficiencies that is beneficial to both cable systems and the agency alike. However, we repeat our core concern that full cost-of-service showings be available for those cable systems as to which other rate regulation approaches may lead to below-cost rates.

There is a single factual basis for each of these conclusions. Like the process of establishing rates by averaging through the benchmark numbers, each of the other proposals discussed above has the effect of blinkering the regulatory process to elements in the operation of a cable system that diverge too dramatically from the average. In part out of a sense of general fairness and, concededly in better part, out of a knowledge of its own affairs and a fear of the result of being "averaged", Media General believes that every system must have the opportunity to present the individualized facts of its operations to the Commission and be given the opportunity to explain why what may be valid on average is inadequate for its particular circumstances. A brief review of Media General's operations may give the flavor of these concerns.

II. The Uniqueness of the Media General System

The Media General system and its operations are certainly atypical and perhaps unique in many respects. The system was built by Media General and has been operated to franchise-mandated specifications from the franchise's inception in 1982. Media General is the franchised cable operator for Fairfax County, Virginia, an area of 400 square miles. The plant consists of a total of 3,862 miles of cable; the majority of this -- 2,188 miles -- is underground cable. In order to provide the franchise-required 450 megahertz, 120-channel capacity with then-available technology, a dual cable system was constructed. This essentially doubles the amount of system electronics, thereby significantly increasing maintenance costs.

The system operates from two headends, feeding ten hubs. The microwave path to hub sites is backed up by a hard coaxial interconnect. At the present time, the system operates in a one-way addressable mode; however, the system was built and activated to accommodate two-way interactivity. The plant is 100% two-way active. Status monitoring equipment has been installed on all system electronics. In order to reduce outages caused by electrical power failures, the system is equipped with battery back-up to all power supplies.

The franchise required a separate 450-megahertz institutional cable system. This 400-mile system has been of no commercial value to date. It is currently an intra-county telephone and data network provided free of charge to the local government, serving over 400 government facilities, with Media General absorbing all of the initial construction and ongoing operating costs.

To date, Media General has spent over $333,000,000 in capital expenditures to build its system. The actual construction of the system also entailed unusual costs. At the time the franchise was awarded, the power and telephone plant serving the area was seriously out of date. Media General incurred "makeready" costs several times higher than the national average, essentially rebuilding a significant portion of the local power and telephone facilities. Underground plant is typically built in highway easements. It is also typical to build one side of a street, cutting the pavement to run drops to houses on opposite side of the street. Media General was prohibited from permanent placement of pedestals in highway easements and from cutting streets to run drops. The company had to obtain private homeowner easements for essentially all of the underground construction. These factors increased construction costs, added plant to the system and continue to affect operating costs. Local franchise area building codes also adversely affected construction costs. Some of the local code requirements were: (1) the obligation to close trenches overnight, and (2) a restriction against working on primary roads before 9 a.m. and after 3:30 p.m.

Fairfax County entailed annual monetary grant obligations of 1.25 percent of total revenues plus $225,000; equipment grant obligations totalling $3,200,000; a 400 mile ICN network -- with half of its bandwidth used solely by Fairfax County as mandated by the franchise -- that has an annual operating cost of several hundred thousand dollars; a commitment to provide 19 channels for public, educational and governmental use of which 11 channels are currently active.

Finally, we believe that the quality of service provided by Media General to the sophisticated and demanding group of subscribers served by it sets it apart from most other cable systems in the country. Media General has provided service that equaled or exceeded FCC standards governing cable system office hours, telephone availability, installations, outages and service calls. Office hours are maintained 12 hours per day, seven days per week. Telephone personnel are available 14 hours per day, seven days per week. Personnel are on duty to respond to hazardous situations 24 hours per day, seven days per week. Media General performs standard installations within seven days after an order has been placed. In fact, Media General usually completes a standard order within three to five days. Media General complies with the outage and service call standards. In fact, Media General responds to one-fifth of all subscriber service requests by visiting the customer's home by the close of business on the same day the call was received. In response to customer demand, Media General accommodates the working schedule of subscribers by offering an extensive number of weekend and after 5:00 p.m. appointment windows. Media General also provides superior customer service by providing superior training for telephone representatives. All newly hired telephone personnel received three weeks of classroom training before handling any customer calls. Thereafter, telephone personnel receive 40 hours of continuing classroom training each year. Media General maintained this overall superior level of service prior to passage of the Cable Act.

As one would expect, none of these special characteristics has come cost-free. For a variety of reasons, including initial franchise authority constraints on rates charged and subsequent consumer resistance to price increases perceived to be too abrupt, as Attachment 1 to this pleading shows, Media General has an accumulated operating deficit of just over $61 million. More than one-half of this (just short of $33 million) was accumulated in 1984 and '85 as the system began operations. Losses dropped to fairly stable levels (approximately $10 million and $11 million, respectively) in 1986 and '87 and then decreased steadily to a break-even point in 1991 and a $3.5 million profit in 1992. This economic history has led Media General to some very pronounced views on some of the substantive questions in to which the Notice inquires.

III. Cable Systems Must Be Permitted to Establish, as a Component of their Cost of Service, a Reasonable Amortized Portion of Historic Accumulated Operating Losses

We recognize that the Commission has not conventionally permitted what have, in other contexts, been called "return deficiencies" to be included in rate base. See, e.g., Communication Satellite Corp. v. FCC, 611 F.2d 883, 892-94 (D.C. Cir. 1977). It is not at all clear that the logic that impelled the Commission to deny COMSAT the "return deficiencies" that it had suffered during the early years of its operations through increased rates in subsequent years is applicable to this proceeding. The court expressly noted, for example, that:

> Where the rates that a regulated company can charge have for some time been under strictures set by an

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> administrative agency, the case for "return deficiencies" could be different. The fact that a reasonable rate of return was not earned might then be explainable by the Commission's miscalculation, and the company, unable to have conducted its affairs in any manner different than it did, might be entitled to recover its losses.

Id., 611 F.2d at 894. Of course, Media General has not been operating "under strictures set by an administrative agency...." It is, however, now being subjected to rate regulations that it could not have predicted earlier in its course of establishing prices for cable services. And, though in a fashion very different from that contemplated in the footnote quoted above, the lack of knowledge of impending rate regulation guided Media General's business decisions just as surely as a prescribed rate would have. That is, Media General made judgments about the proper slope of rate increases that likely would have been very different had it known that rate regulation, much less rate regulation that might challenge its capacity to recoup past operating losses, would soon be upon it. The equities might be different had Media General not owned and operated the Fairfax system from its inception or if any part of the operating losses resulted from activities other than the construction and operation of the system.

In any event, Media General is not here requesting the inclusion of past operating losses in rate base. Instead, we endorse the "intermediate approach" proposed by the Commission at paragraph 43 and n.47 of the Notice for dealing with past period expenses not then recovered. The Commission's suggestion that such costs be amortized "... but exclude[d] ...

from rate base ..." seems to Media General an adequate recovery methodology. This is entirely consistent with the procedures endorsed by the Communications Satellite Corp. court:

> The fairness of not permitting the capitalization of previous earnings shortfalls is further emphasized by the fact that COMSAT in determining its rate base and as special items for recoupment was allowed liberal expense allowances for many of the factors that contributed to the overall earnings deficiency, including interest during construction, satellite incentive payments, depreciation, and amortization. .... In all, $91,596,300 of the claimed $91,605,000 losses were allowed.

Id., 611 F.2d at 894.

As the Commission notes, this will not permit cable companies the full return on what is, at least in the case of Media General, an important element of investment. It will, however, accomplish the absolutely vital end of permitting the recovery of past losses. As has been noted in another context, without funds from some outside source, business cannot go on unless permitted to recover costs. National Association of Greeting Card Publishers v. U.S. Postal Service, 607 F.2d 392 (D.C. Cir. 1979), cert. denied, 444 U.S. 1025 (1980). Indeed, the Postal Rate Commission, operating under an admittedly somewhat different statutory scheme for rate regulation, regularly permits the inclusion of past year losses in future year revenue requirements. The Commission's considerably more modest proposal here ought to be adopted.

The remaining question, as framed by the Commission in footnote 47 of the Notice is the proper period of amortization for prior year losses.

This issue, it seems to us, is one not suited to a singular response. The appropriate interval for recoupment of prior year losses is, like many of the issues associated with setting appropriate rates based on cost of service, an issue individual to the circumstances of the cable system requesting special consideration. Obviously, the period of recoupment should not be too short, or it would justify price increases too large. In part, the market is an appropriate mechanism for safeguarding against that. Indeed, it is precisely because the individualized circumstances of cable systems and the market in which they operate will prove determinative of the right period of time for recoupment of past losses that a universally applicable amortization period is inappropriate.

IV. The FCC Need Not and Should Not Establish Uniform Depreciation Lives for Cable System Assets

For many of the same reasons discussed immediately above, the Commission's tentative conclusion that it "... should prescribe depreciation rates for purposes of developing cost-based rates for regulated cable service" is misguided. Notice, ¶ 27. At present, many, if not all, cable systems are considering devices for expanding their carriage capacity. Two common methodologies for accomplishing this are the investment in electronic equipment to compress signals, which will have the effect of permitting more channel capacity on existing coaxial cable and replacing existing coaxial facilities with higher capacity (generally, fiber optic) pathways. Were the Commission to determine the depreciable life of coaxial cable, that decision would undoubtedly skew decisions concerning the appropriate technology for expanding system capacity. That would be a mistake. Decisions of that kind ought to be committed to the more discerning and circumstance-specific judgment of cable operators.

It is also not necessary for the FCC to prescribe depreciable asset lives in order to insure the integrity of cost-of-service proceedings. At least for systems that have annual audited financial statements, the integrity of depreciation measures assured by GAAP will adequately secure this interest. See, Ernst & Young, Depreciation Safeguards Under GAAP, filed with the reply comments of United States Telephone Association in CC Docket No. 92-296 (Apr. 13, 1993). As the Ernst & Young essay makes clear, the Financial Accounting Standards Board, to which the Securities Exchange Commission has delegated its authority to prescribe and enforce general accounting principles,[2/] assure that useful life, for depreciation purposes, will be appropriately recorded in audited financial statements. This is particularly true if the Commission tests costs of service on an historical test-year basis as to which cable companies would not have the opportunity , even if they had the ambition, to influence auditor approved depreciation lives for ratemaking purposes.

2/ The Ernst & Young piece makes an equally persuasive case that the market demands for accurate and relevant information would, taken alone, accomplish the same result.

The FCC would work unnecessarily, and perhaps also come to results less satisfactory than those dictated by the case-by-case application of GAAP, if it were to supplant this mechanism.

V. Once Cost-of-Service Rates are Adjudicated, They Should be Moved Forward from Year-to-Year on a Price Cap Basis, with the Option Always Available for Cable Systems to Re-Litigate Cost-of-Service Annually

Although it is implicit in the Notice, the Commission should clearly state that, if a cable system is content with the cost-of-service rates that it has achieved through an adjudication, it may maintain that level of rates, increased by the price-cap mechanism applicable to the benchmark/adjusted historical rates from year-to-year. We endorse the Commission's notion that cost-of-service proceedings should not be permitted more than once every 12 months.

Although the Commission has concluded that it should use the national GNP-PI as the annual inflation mark-up for established cable rates, we submit that, where a cable operator is able to establish in the course of its cost-of-service showing that inflation in its service area substantially exceeds national averages, alternate inflaters can be determined to be appropriate. The Bureau of Labor Standards publishes, in the Monthly Labor Review, CPI numbers for metropolitan areas as well as for the United States. The June, 1993 issue of that publication showed a nationwide CPI of 140.3

(based on a 1982-84 base) and showed the following metropolitan area numbers:

New York	149.9
Philadelphia	147.4
Boston	151
Cleveland	130.8
Miami	135.9
St. Louis	135.4
Washington, DC	145.6

Obviously, inflation in the Washington, DC-metropolitan area outpaces the national norm (though it lags behind some areas); this justifies an annual price cap inflation factor that rises above the national average.

VI. A Mark-up on Programming Expense Should be Permitted in the Cost-of-Service Showing

The Commission inquired, in n.24 of the Notice "... whether cable operators will continue to have sufficient incentives to provide adequate levels of programming service without an allowed profit on programming expense." Media General believes that the answer to this question is an emphatic "no." Obviously, operators have no incentive to add or improve programming in a benchmark/price cap regulatory environment. In fact, they are encouraged to migrate toward the lowest cost source of basic programming, regardless of content or consumer interest, and to increase pay-per-view and premium offerings. Allowing mark-ups on a programming investment does not necessarily result in higher subscriber costs. Better programming should increase basic cable penetration which in turn should lead to lower costs per subscriber.

VII. Additional Procedural Matters

There are two additional matters, not directly addressed in the Notice, that Media General believes the Commission should decide in this proceeding. The first has to do with the jurisdictional division of authority between the FCC and state or local jurisdictions over cable rates. It is the present intention of Media General to price its basic tier of service at benchmark-justified rates and to establish that its cost of service justifies higher than benchmark rates for its non-basic tier. This raises the possible conflict of jurisdiction between the Commission and local regulators. The Commission should determine that, whenever a cable operator seeks to establish a cost-of-service justification for rates above the benchmark for non-basic service, the FCC has exclusive jurisdiction to adjudicate all cost-of-service questions. This will avoid any possible conflict, and a very unattractive possibility of conflicting results, arising from the possibility of cost-of-service adjudications by both federal and state or local authorities.

Media General suspects that there will be occasions, and indeed it anticipates raising at least one of them, where a single channel is used a portion of the time to provide rate regulated service and, during other periods, to provide pay-per-view or otherwise unregulated services. The Commission ought to determine the appropriate cost-accounting treatment for such split-use channels. We propose that costs, for cost-of-service purposes, be associated with such channels in proportion to monthly hours of use for rate-regulated purposes. If, for example, the channel is used 360 hours per month for rate-regulated service and an equal period for pay-per-view, it would count as one-half a channel for cost-of-service calculations.

Respectfully submitted,

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August 25, 1993

Media General Cable
Breakdown of Accumulated Deficit

	Operating Income (Loss)	Interest Expense	Depreciation & Amortization	Tax Provision (Credit)	Annual Net Income (Loss)	FASB 96 Adjustment	Accumulated (Deficit)
1984							
Revenue	$5,778,950						
Op. Exp.; G&A	8,923,954						
Op. Inc (Loss)	($3,145,004)	$4,742,345	$3,123,680	$0	($11,011,029)	$0	($11,011,029)
1985							
Revenue	$22,144,961						
Op. Exp.; G&A	22,100,487						
Op. Inc (Loss)	$44,474	12,983,743	8,854,531	0	(21,793,800)	0	($32,804,829)
1986							
Revenue	$36,265,710						
Op. Exp.; G&A	32,082,603						
Op. Inc (Loss)	$4,183,107	14,354,339	14,580,170	(14,940,068)	(9,811,314)	0	($42,616,143)
1987							
Revenue	$57,613,251						
Op. Exp.; G&A	42,566,454						
Op. Inc (Loss)	$15,046,797	16,974,228	17,967,536	(8,897,381)	(10,997,586)	8,154,538	($45,459,191)
1988							
Revenue	$69,928,533						
Op. Exp.; G&A	47,547,262						
Op. Inc (Loss)	$22,381,271	13,700,789	19,580,003	(2,301,530)	(8,597,991)	0	($54,057,182)
1989							
Revenue	$78,336,730						
Op. Exp.; G&A	50,877,588						
Op. Inc (Loss)	$27,459,142	15,292,322	21,102,743	(2,120,993)	(6,814,930)	0	($60,872,112)
1990							
Revenue	$90,317,273						
Op. Exp.; G&A	58,563,647						
Op. Inc (Loss)	$31,753,626	15,000,016	22,796,386	(2,187,120)	(3,855,656)	0	($64,727,768)
1991							
Revenue	$100,103,466						
Op. Exp.; G&A	62,854,963						
Op. Inc (Loss)	$37,248,503	13,861,686	23,568,236	(246,541)	65,122	0	($64,662,646)
1992							
Revenue	$108,897,821						
Op. Exp.; G&A	69,042,313						
Op. Inc (Loss)	$39,855,508	11,546,215	22,861,858	1,908,082	3,539,353	0	($61,123,293)
CUMULATIVE	$174,827,424	$118,455,683	$154,436,143	($28,785,571)	($69,277,831)	$8,154,538	($61,123,293)

Attachment 1